

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
<b>FINCH, PRUYN &amp; CO., INC.</b>	:	DETERMINATION
	:	DTA NO. 817024

for Redetermination of a Deficiency or for Refund of :  
Corporation Franchise Tax under Article 9 of the Tax  
Law for the Period June 1, 1993 through May 31, 1997. :

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Petitioner, Finch, Pruyn & Co., Inc., One Glen Street, Glens Falls, New York 12801, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9 of the Tax Law for the period June 1, 1993 through May 31, 1997.

On April 23, 2002 and April 26, 2002, respectively, petitioner by its representative, McNamee, Lochner, Titus & Williams, P.C. (Robert D. Plattner, Esq., of counsel), and the Division of Taxation by Barbara G. Billet, Esq. (Kathleen D. O'Connell, Esq., of counsel) waived a hearing and agreed to submit the matter for determination based on documents and briefs to be submitted by December 24, 2002 which commenced the six-month period for the issuance of this determination. After review of the evidence and arguments presented, Arthur S. Bray, Administrative Law Judge, renders the following determination.

***ISSUES***

I. Whether the Division of Tax Appeals has jurisdiction to determine whether the Gas Import Tax is unconstitutional on its face.

II. Whether *Tennessee Gas Pipeline Co. v. Urbach* (96 NY2d 124, 726 NYS2d 350) is determinative of the issues presented in this matter.

III. Whether the Gas Import Tax violates the Commerce Clause and Due Process Clause of the United States Constitution.

***FINDINGS OF FACT***

1. During the period in issue, June 1, 1993 through May 31, 1997, petitioner, Finch, Pruyn & Co., Inc. (“Finch, Pruyn”), was a New York corporation which operated a manufacturing facility in Glen Falls, New York. Its corporate headquarters were also located in Glens Falls, New York.

2. Petitioner purchased natural gas outside the State of New York that was brought into New York through an interstate pipeline. The gas was delivered to petitioner and consumed by petitioner at its facility in Glens Falls.

3. Following a field audit, on January 13, 1997, petitioner paid the Division of Taxation (“Division”) \$212,201.19 as payment in full for the taxes, penalty and interest asserted to be due by the Division under Tax Law §§ 189 and 189-b for the period June 1, 1993 through November 30, 1996. Petitioner paid the Division taxes pursuant to Tax Law §§ 189 and 189-b for the period December 1, 1996 through February 28, 1997 in the amount of \$2,242.20 and petitioner paid the Division taxes pursuant to the same sections of the Tax Law for the period March 1, 1997 through May 31, 1997 in the amount of \$19,369.20.

4. On September 11, 1997, petitioner filed a Claim for Refund of Section 189 and Tax Surcharges in the amount of \$233,813.08 for the period June 1, 1993 through May 31, 1997. The refund claim stated that Tax Law § 189 violated the Commerce Clause of the Federal Constitution.

5. The Division has held petitioner’s refund claim in abeyance pending the resolution of court cases seeking to have Tax Law § 189 declared unconstitutional.

***Petitioner's Proposed Findings of Fact***

6. Petitioner has submitted the following three proposed findings of fact:

1. During the period of the refund claims, the annual volume of gas sold by unregulated marketers to New York purchasers was in the hundreds of millions of Mcfs.

2. During the period of the refund claim, the approximate volume of gas sold by unregulated marketers to New York purchasers, as a percentage of all natural gas sold to New York purchasers, was as follows:

1993	25.4%
1994	26.7%
1995	32.2%
1996	29.1%
1997	33%

3. The respondent did not offer any evidence regarding the annual volumes of gas sold in New York during the refund period by unregulated marketers in which title passed in New York.

7. In accordance with New York State Administrative Procedure Act § 307(1), petitioner's proposed findings of fact have been rejected. The first proposed finding of fact is rejected because the statement is irrelevant. As pointed out by the Division, the relevant inquiry centers on the significance of the level of sales within the State in which consumers might have avoided taxation under Tax Law §§ 186 and 186-a because unregulated marketers were not required to pass through such tax to the ultimate consumer.

8. Proposed finding of fact two is also rejected. On the premise that transportation sales volumes as set forth in the statistical tables published by the Public Service Commission ("PSC") constitute volumes of gas sold by unregulated marketers, petitioner compared total transportation sales volumes for the year to total sales volumes and stated that the result was the percentage of all gas used in New York State arising from sales by unregulated marketers. The PSC does not have information that establishes what portion of the transportation sales volumes involved sales

in which title to the gas passed within New York. As a result, volumes of gas imported into New York which are taxable under Tax Law § 189 are included in the transportation sales volume figures. Consequently, the computations do not show what percentage of section 186 sales skirts the compensatory tax scheme because such sales are made by unregulated marketers who are not required to pass the Tax Law § 186 tax on to their customers. It is noted that when the Court of Appeals rejected similar arguments with respect to unregulated marketers, it cited the same publications of the Public Service Commission which are relied upon by petitioner to support this finding of fact (*Tennessee Gas Pipeline Co. v. Urbach*, 96 NY2d 124, 726 NYS2d 350, 355, n. 6).

9. Petitioners' third proposed finding of fact is rejected because it constitutes an improper attempt to shift the burden of proof to the Division (State Administrative Procedure Act § 306[1]).

### ***CONCLUSIONS OF LAW***

A. The historical context in which the issues presented herein arise is helpful in understanding the issues in this matter. In 1978, Congress passed the Natural Gas Policy Act (15 USC § 3301, *et seq.*) which precipitated the deregulation of the natural gas industry.<sup>1</sup> At the time this Act was passed, interstate pipeline companies were able to control prices in New York because they controlled the mechanism for the distribution of gas from the wellhead to the regulated utilities. In 1992, the pipelines became common carriers of natural gas as a result of an order by the Federal Energy Regulatory Commission ("FERC") which directed all interstate pipelines to "unbundle" their transportation services from their gas sales. As a result, large

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<sup>1</sup> The history of the deregulation of the natural gas industry is explained in *General Motors Corp. v. Tracy* (519 US 278, 283-297) and *Tennessee Gas Pipeline Co. v. Urbach* (96 NY2d 124, 726 NYS2d 350). The history set forth above was obtained largely from *Tennessee Gas*.

industrial buyers could circumvent local utilities and purchase natural gas directly from suppliers. The gas is delivered by a New York Gas utility or by pipeline. In accordance with FERC-approved tariffs, the cost which the user pays for transporting the gas is separate from the purchase price of the gas.

New York's system of taxing natural gas, which was developed prior to the deregulation of the natural gas industry, focused upon the entities which sold gas in New York. Tax Law § 186(1) imposes tax on a corporation, joint stock company or association engaged in the business of supplying gas which is delivered through mains or pipes. The tax is assessed at a rate of .75 percent upon all sources within New York. In addition, a tax of 3.5 percent on the gross income or gross operating income of gas sellers for gas sales for "ultimate consumption or use in New York" is imposed by Tax Law § 186-a(1). Although the forgoing taxes may not be identified on a customer's bill, they are passed through to the gas utilities' customers pursuant to a Public Service Commission tariff. As a result of the deregulation of the natural gas industry, customers were able to avoid the taxes which were passed through by purchasing gas from out-of-State producers.

In order to recover the taxes which were being avoided and to equalize the tax burden the Legislature enacted the Natural Gas Import Tax ("gas import tax") (L 1991, ch 166, §§ 147-149). Section 149 explains the legislative intent behind this enactment as follows:

the main goal of this act is to attempt to equalize the tax burden in relation to consumers of gas service. Presently, consumers of gas services may avoid the burden of the taxes imposed by sections 186 and 186-a of the tax law by purchasing the service out-of-state and hiring transportation to carry that service to the consumer's premises in this state. The legal incidence of the taxes imposed by sections 186 and 186-a of the tax law are on the utility making sales of gas services in this state. However, both of these taxes are presently passed through by the utility separately, and in their entirety, to consumers purchasing gas services from such utility in this state pursuant to rate regulation of the charge for

such services by the public service commission. Thus, consumers of gas services purchased in this state from utilities bear the direct pass-through of both such taxes. Sections one hundred forty-six through one hundred forty-nine-a of this act are an attempt to impose on those consumers who purchase gas services outside this state a comparable fair tax burden. Accordingly, to insure continuing comparability, pursuant to regulation by the public service commission, utilities shall be required to continue to pass through the total amount of such taxes to in-state consumers so that such consumers will continue to bear the economic burden of such taxes. In this manner a continuing comparable economic burden is imposed by such sections of this act on these consumers who purchase gas service out-of-state for use or consumption in this state as compared to consumers who purchase gas services in this state from utilities.

The gas import tax imposes tax “for the privilege or act of importing gas services or causing gas services to be imported into this state for its own use or consumption in this state.” (Tax Law § 189[2][a].) During the years in issue, the tax was imposed at a rate of 4.25 percent of the consideration given or contracted to be given by the gas importer for the gas imported into this State for its own use or consumption (Tax Law § 189[2]).

B. Initially, petitioner challenged the denial of the refund claim in a proceeding pursuant to Article 78 of the CPLR on the basis that the gas import tax was unconstitutional on its face. The Supreme Court dismissed the petition as premature, without prejudice to petitioner exhausting its administrative remedies (*Finch, Pruyn & Co. v. Urbach*, Sup Ct, Albany County, March 9, 1999). The Court held that there were factual issues regarding the implementation of the statute that had to be addressed by the administrative agency. This proceeding followed. The Supreme Court also dismissed as premature a constitutional challenge to the gas import tax raised by Tennessee Gas Pipeline Company (“Tennessee Gas”). Tennessee Gas appealed the dismissal to the Appellate Division which found no merit to a facial challenge to the statute. Further, it agreed with the Supreme Court that Tennessee Gas’s challenge was aimed at the statute as applied and directed Tennessee Gas to pursue its administrative remedies (*Tennessee*

*Gas Pipeline Co. v. Urbach*, 269 AD2d 19, 708 NYS2d 193). Tennessee Gas pursued its claim to the Court of Appeals which reversed the Appellate Division and found the statute unconstitutional on its face (96 NY2d 194, 726 NYS2d 350, *supra*).

Initially, the Court found that the gas import tax discriminated against interstate commerce because it imposed a tax on out-of-State purchases of gas consumed in New York while not imposing a tax on in-State purchases of gas in New York (*id.*, 726 NYS2d at 353). The Court then proceeded to examine the Division's argument that the gas import tax could withstand a Commerce Clause challenge because the tax complemented the taxes imposed by Tax Law §§186 and 186-a. This was accomplished through an examination of three criteria which, if satisfied, would lead to the conclusion that a "complementary" or "compensatory" tax would satisfy the Commerce Clause despite its discrimination against interstate commerce. The three criteria are as follows:

First, it must identify the intrastate tax burden for which it attempts to compensate. Second, the interstate tax must "roughly approximate," but not exceed, the amount of the tax on intrastate commerce. Third, the events on which both taxes are imposed must be "substantially equivalent;" that is they must be sufficiently similar in substance to serve as mutually exclusive 'prox[ies]' for each other"(citations omitted) (*id.*, 726 NYS2d at 354).

With respect to the first criteria, there was no dispute that the Legislature's intent was to create equality for consumers of gas without regard to the location of the source of the gas.

In regard to the second criteria, the Court noted that the sum of the in-State tax rates equaled the import tax rate. Tennessee Gas sought to refute this analysis on the basis that the out-of-State tax was imposed on consumers while the in-State tax was imposed on the utility which then passed the tax on to the consumer. This argument was rejected because the practical effect of the statutes was the same. The Court also rejected the argument that not all suppliers

are regulated by the Public Service Commission and therefore not required to pass the tax through to customers. In this regard, the Court found that Tennessee's submissions did not convince them that sales of gas subject to sections 186 and 186-a pass-through taxes as compared to unregulated sales establish the "substantial distinctions and real injuries" which are necessary for a challenge under the Commerce Clause (*id.*, 726 NYS2d at 355).

The third criterion of a valid compensatory tax is whether the events on which the taxes are based are substantially equivalent. That is, they must be sufficiently similar so as to be exclusive proxies for each other. Tennessee Gas argued that sections 186 and 186-a of the Tax Law are franchise taxes whereas section 189 of the Tax Law is an import tax. It was submitted that the taxing events are so different they could not be viewed as taxing similar economic activity. The Court rejected this argument on the basis that, because of the pass through, both taxes essentially tax the sale of gas. Further, the taxes could not overlap because a consumer would either buy the gas in-State or import it.

Tennessee Gas's last argument was based on "fair apportionment" and, in this case, Tennessee Gas limited its argument to whether the taxes were internally consistent. The Court explained the concept of internal consistency by quoting the following passage from *Oklahoma Tax Commn. v. Jefferson Lines* (514 US 175, 185, 131 L Ed 2d 261):

Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear. This test asks nothing about the degree of economic reality reflected by the tax, but simply looks to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate. A failure of internal consistency shows as a matter of law that a State is attempting to take more than its fair share of taxes from the interstate transaction. (*id.*).



The Court concluded that Tax Law § 186 violates the internal consistency test because if consumers purchased gas in a State with a provision identical to Tax Law § 186, they would pay a pass-through tax despite the fact that the gas was exported to and consumed in New York. Thus, a double tax occurs because the import tax contains no provision for a credit for taxes imposed on the out-of-State purchase of gas.

Lastly, the Court declined to utilize certain savings language to cure the defect because it was viewed as violating certain separation of powers principles.

C. In response to the Court's decision in *Tennessee Gas*, the Legislature enacted chapter 383 of the Laws of 2001 which established a retroactive credit for taxpayers who paid in another jurisdiction a tax similar to that imposed by Tax Law § 186.

D. In its brief, petitioner first argues that, on its face, the gas import tax discriminates against interstate commerce in violation of the Commerce Clause of the United States Constitution because gas users pay the gas import tax on gas they purchase in interstate commerce but they do not pay the tax on gas purchased in New York. Petitioner further argues that the gas import tax fails "[t]he third prong of the Court's three-part test . . . which requires the compensatory tax to fall on substantially equivalent events as the interstate levy in such a way that the two can serve as mutually exclusive proxies for each other." (Petitioner's brief, p.14.) According to petitioner, New York's compensatory tax scheme is flawed because of the assumption that vendors subject to Tax Law §§ 186 and 186-a will pass along the full amount of the tax in each instance with respect to unregulated gas marketers. In this regard, petitioner posits that its exhibits show that unregulated gas marketers' share of the total gas market was more than 25 percent in each year in issue. Thus, it is argued by petitioner that it and other purchasers of imported gas are impermissibly burdened by New York's taxing scheme.

Petitioner posits that there are other difficulties with New York's tax scheme. Petitioner notes that Tax Law § 186 is a franchise tax on corporations principally engaged in the sale of natural gas. Thus, petitioner submits that corporations that sell natural gas are only required to pay tax under Tax Law § 186 if 50 percent of their receipts are from the sale of natural gas and other utility services. Petitioner further argues that partnerships, LLCs taxed as partnerships and sole proprietorships are not subject to Tax Law § 186 at all. As a result, the tax rate paid on New York sales by the latter entities is 3.5 percent less than the 4.25 percent imposed under Tax Law § 189. It is submitted that this constitutes blatant discrimination against interstate commerce.

Petitioner notes that corporations subject to section 186 are not subject to the corporation franchise tax imposed by Article 9-A of the Tax Law. Consequently, consumers purchasing gas from a New York seller subject to sections 186 and 186-a would not incur any pass along corporate franchise taxes paid to New York. On the other hand, petitioner argues that the possibility exists that a New York consumer who purchases gas in another state for import into New York paid corporate franchise tax to the state where the sale took place. Therefore, these consumers face the possibility of paying the New York tax and the corporate franchise tax of the foreign corporation.

Lastly, petitioner argues that *Tennessee Gas* was decided on a poor factual record. According to petitioner, it has submitted uncontroverted evidence that unregulated marketers accounted for more than a quarter of all gas sold during the refund period. Petitioner maintains that, based upon this evidence, the Division must show that section 189 is a valid compensatory tax in a market which consists of both regulated utilities and unregulated marketers.

E. In response to the foregoing, the Division argues that the Division of Tax Appeals lacks jurisdiction to determine the constitutionality of a statute on its face which is the sole

challenge raised by petitioner. It also argues that the doctrine of *stare decisis* requires that the *Tennessee Gas* decision be followed. Lastly, the Division contends that the gas import tax is a valid compensatory tax which does not discriminate against interstate commerce. In this regard, the Division submits that the gas import tax approximates, without exceeding, the taxes imposed by Tax Law §§ 186 and 186-a on gas sales in New York, that the gas import tax and Tax Law §§ 186 and 186-a are imposed on substantially equivalent events and that the authority relied upon by petitioner is distinguishable.

F. In its reply brief, petitioner contends that the outcome of *Tennessee Gas* would have been different if Tennessee Gas's submissions had convinced the Court that the gas market share of unregulated sellers was substantial. According to petitioner, it has established that the market share of unregulated marketers was in the range of 25 percent to 33 percent during the period in issue. Petitioner maintains that by arguing that the relevant statistic is the volume of gas sold by unregulated marketers in which title passes in New York the Division is ignoring the clear language of *Tennessee Gas*. According to petitioner, the volume of sales by unregulated marketers in which title passed in New York was not an issue in *Tennessee Gas* and should not be an issue here. Petitioner further submits that the question of where title passes in New York is largely a matter of form over substance. According to petitioner, the burden of proving that § 189 is a valid compensatory tax is on the Division and there is no evidence to suggest that only a *de minimis* volume of gas sold by unregulated marketers to New York customers was sold under a contractual arrangement such that title passed in New York. Lastly, petitioner argues that it is the Division's burden to offer evidence regarding the volume of sales by unregulated marketers in which title passed in New York. In this regard, petitioner contends that it has offered evidence that the total volume of sales by unregulated marketers is very large and it is

reasonable to assume that some portion of this total includes sales in which title passed in New York. Petitioner further argues that Tax Law § 189 provides a specific statutory mechanism that permits purchasers acquiring gas from unregulated marketers to submit a form to the utility stating that the sale of such gas was subject to section 186 and/or section 186-a and that section 189 tax should not be collected. Petitioner contends that this legislation was a response to buyers purchasing gas from unregulated marketers and taking title in New York. Lastly, petitioner points to the difference between the amounts that regulated energy utilities paid under sections 186 and 186-a and the greater amount of New York's collections as evidence that unregulated sales were more than *de minimis*.

G. Petitioner, in its presentation to the Supreme Court, and the Division, in its argument to the Division of Tax Appeals, have each pointed out that the challenge to the gas import tax is based on questioning the constitutionality of the law on its face.<sup>2</sup> As argued by the Division, the Division of Tax Appeals does not have jurisdiction to determine the constitutionality of a statute on its face. This principle was recently reiterated in *Matter of Eisenstein* (Tax Appeals Tribunal, March 27, 2003) wherein the Tribunal stated:

The Division of Tax Appeals is a forum of limited jurisdiction and is not authorized to determine the facial constitutionality of statutes (*Matter of J.C. Penney Co.*, Tax Appeals Tribunal, April 27, 1989; *Matter of Fourth Day Enters.*, Tax Appeals Tribunal, October 27, 1988). However, the Division may determine whether tax law statutes are constitutional as applied (*see, Matter of David Hazan, Inc.*, Tax Appeals Tribunal, April 21, 1988, *confirmed Matter of David Hazan, Inc. v. Tax Appeals Tribunal*, 152 AD2d 765, 543 NYS2d 545, *affd* 75 NY2d 989, 557 NYS2d 306).

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<sup>2</sup> Although the parties may not, by agreement, confer or diminish the jurisdiction of the Division of Tax Appeals, it is noted that petitioner's reply brief did not challenge the Division's argument that the Division of Tax Appeals did not have jurisdiction.

Here, the arguments raised by petitioner are clearly facial challenges to the statute. The decision of the Court of Appeals in *Tennessee Gas* treated the same arguments as legal issues not warranting an administrative hearing. Thus, the arguments that the gas import tax is invalid *per se* because it discriminates on its face against interstate commerce in violation of the Commerce Clause; that the gas import tax does not meet the requirements of a valid compensatory tax; that the retroactive credit provision does not cure the gas import tax's constitutional infirmity as an invalid compensatory tax; and that the 2001 amendments to the gas import tax which apply retroactively to 1991 and thereafter violate petitioner's due process in regard to its refund claim are all arguments which may not be considered by the Division of Tax Appeals.

H. The petition of Finch, Pruyn & Co., Inc. is denied.

DATED: Troy, New York  
June 24, 2003

/s/ Arthur S. Bray  
ADMINISTRATIVE LAW JUDGE